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Supreme Court of the United States

October Term, 1944.

No. 1187

HARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,

Petitioner,

vs.

WEBSTER EISENLOHR, INC.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF AND APPENDIX.

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SUPREME COURT OF THE UNITED STATES.

October Term, 1944.

No.

HARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,

Petitioner,

vs.

WEBSTER EISENLOHR, INC.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

TO THE HONORABLE, THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioner, Harry E. Kalodner, Judge of the District Court of the United States for the Eastern District of Pennsylvania, by his attorney, respectfully prays that a Writ of Certiorari issue to review the judgment, order and peremptory writ of mandamus of the United States Circuit Court of Appeals for the Third Circuit in the above entitled case, ordering, requiring, and commanding the

petitioner to vacate, revoke, set aside and declare null and void and of no effect an order of June 9, 1943 entered in an action pending in the petitioner's court by Andrew J. Speese, 3rd, as plaintiff against Webster Eisenlohr, Inc. as defendant, Civil Action No. 2941 in the District Court of the United States for the Eastern District of Pennsylvania, in which said order the petitioner appointed one David Bortin special master to investigate, take testimony and report to the court.

STATEMENT OF MATTER INVOLVED.

This case involves

(a) the question whether a District Judge's interlocutory and discretionary reference to a master in a spurious class suit, praying inter alia for the appointment of a receiver, wherein a compromise of the suit was reached between the defendant on one hand and the plaintiff and others in his class on the other hand, may be controlled or reviewed by mandamus in the Circuit Court, and

(b) whether such order was not proper under the provisions of Rule 23(c) of the Federal Rules of Civil Procedure, which provides that no compromise in a class action may be reached without approval of the Court; and because of the prayer for the appointment of a receiver and the allegations of fraud in the complaint.

THE ESSENTIAL FACTS.

(Note: For purposes of clarity, Harry E. Kalodner, the petitioner in this Court, respondent in the Circuit Court,

and Trial Judge in the District Court, will sometimes hereinafter be referred to as "Trial Judge"; and Webster Eisenlohr, Inc., defendant in the District Court, petitioner in the Circuit Court, and respondent in this Court, will sometimes hereinafter be referred to as "Eisenlohr".)

Eisenlohr, while defendant in a litigation in the District Court for the Eastern District of Pennsylvania, filed its petition (R. 1-42) in the Circuit Court of Appeals for the Third Circuit, praying that the Circuit Court grant a writ of mandamus directed to the Honorable Harry E. Kalodner, Judge of the said District Court, requiring and commanding him to vacate an order of June 9, 1943, referring certain issues to a Special Master (R. 11). Upon this petition, the Circuit Court issued a rule to show cause why the petition for mandamus should not be granted (R. 103).

The plaintiff in the District Court had filed a complaint in a civil action for himself and others in the same class against Eisenlohr as defendant (R. 15-20). The complaint alleged that

(a) The defendant was a corporation (R. 15).

(b) Two classes of stock had been issued: some 4090 shares of common and 5037 shares of preferred (R. 16).

(c) Plaintiff was a preferred stockholder (R. 15).

(d) Annual dividends on the preferred were $7.00 per share (R. 16).

(e) Two quarterly dividends on the preferred had been passed (R. 16).

(f) By virtue of the provisions of the by-laws, the preferred stockholders were in consequence entitled to exclusive voting power (R. 16-17).

(g) This exclusive voting power had been denied holders of the preferred stock (R. 18).

(h) Dividends on preferred stock had remained unpaid since April of 1931, and as of December 31, 1941, amounted to $75.25 per share (R. 16).

(i) The defendant company was dominated and controlled by the Chase National Bank of New York through its ownership of a large block of the common stock (R. 18).

(j) The control and management of the company was being usurped by alleged officers and directors by the illegal action of the company in denying exclusive voting power to the preferred stock (R. 19).

(k) The usurpation was in fraud of the rights and privileges of the preferred stockholders (R. 19).

(l) The assets and management of the company were being managed, controlled and disposed of for the sole benefit of the holders of the common stock to the injury and prejudice of the preferred stockholders (R. 19).

The complaint prayed for special relief granting exclusive voting power to the preferred stockholders, for the appointment of a receiver, and for general relief (R. 19-20).

The defendant Eisenlohr filed an answer admitting the passing of the dividends (R. 22), but denying other material allegations of the complaint, and challenging the plaintiff's construction of the by-laws concerning the vesting of exclusive voting power in the preferred stock, after the passing of two dividends (R. 24).

Several hearings were held before the Court. Both parties were represented by counsel. In the course of the hearings certain facts transpired through the medium of admissions by counsel for both parties, and submission of various documents and letters to the Court by counsel for the defendant. One other fact came to light by virtue of published notices of the Securities and Exchange Commission.

These developments were:

(a) On March 23, 1943, subsequent to the institution of this litigation, the defendant company sent to stock-

holders, including holders of the preferred, copies of the company's annual report for 1942 (R. 4).

(b) The following appeared on Page 1 of the report:

"The net profit from operations for the calendar year amounted to $405,451.73 before provision for Federal Income Taxes, and to $235,751.73 after deduction of $169,700 as the estimated amount required for such taxes, as compared with $192,595.24 for the preceding calendar year in which no provision for Federal Income Taxes was considered necessary or made. This was equivalent to 49¢ per share on the common stock for 1942, after deduction of the estimated amount required for such taxes *and after allowance for unpaid preferred dividends accrued in said year*, as compared with 38¢ per share for the preceding year 1941." (Italics supplied) (R. 27).

(c) Preferred stock called for redemption was entitled to be paid for at the rate of $115.00 per share, plus accumulated dividends, or $197.25 per share (R. 31).

(d) Upon liquidation preferred stock was entitled to be paid for at the rate of par plus accumulated arrearages of dividends ($182.25) before common stock could participate (R. 24).

(e) Under date of March 26, 1943, the Company caused letters to be sent to all preferred stockholders offering to purchase the preferred stock at $150.00 per share flat (R. 4).

(f) There was no disclosure (in connection with the offer of purchase) that accumulated arrearages of dividends on the preferred stock ($82.25 per share) must be paid before dividends could be declared on common stock (R. 34, 49-50, 106).

(g) There was no disclosure (in connection with the offer of purchase) as to the amounts to be paid for preferred stock on liquidation or redemption (R. 34, 49-50, 106).

(h) The earnings for the first quarter of 1943 amounted to $26.00 per share on the preferred stock. There was no disclosure of this fact to the holders of preferred stock (R. 34, 52, 54, 58, 106).

(i) Those in management or control of the company sent to counsel for the complainant a list of holders of shares of preferred stock and offered to pay said counsel the sum of $7.50 per share (equivalent to $750.00 per hundred share certificate) as a brokerage commission for all shares which he assisted the company to purchase from preferred stockholders. This fact was not disclosed to preferred stockholders (R. 34, 112, 106-7, 136).

(j) Those in management or control of the company agreed in addition to pay a brokerage fee of $10,000.00 to a brokerage firm for procuring the sale of stock from preferred stockholders in general at the price of $150.00 per share flat. This fact was not disclosed to the preferred stockholders (R. 111, 34, 107, 136).

(k) Securities Exchange reports published in the newspapers showed that Everett Meyer, president and director of the defendant company, had purchased 4700 shares of common stock of the defendant company in May, 1943 (R. 106).

Certain other facts transpired partly at the hearings and partly at the reargument before the Court below. They were:

Prior to the hearing of May 24, 1943 before the District Court, Eisenlohr had purchased the stock of Speese, plaintiff in the District Court, and of other stockholders represented by Speese's counsel (R. 4, 75). Only a few stockholders remained who had not sold their preferred stock to the company (R. 75). Counsel for plaintiff several times referred to the transactions as a "settlement" of the litigation (R. 75).

4047 shares of the preferred stock outstanding had been purchased by Eisenlohr for $150.00 flat per share: 990

shares were still outstanding on or about June 7, 1943 (R. 5, 35).

Subsequently and prior to rehearing in the Circuit Court Eisenlohr redeemed all preferred stock not theretofore purchased by it as authorized by the charter (presumably at $197.25 per share) (R. 136).

On June 9, 1943 the Trial Judge entered an order of reference to David Bortin, Esq., a member of the Philadelphia Bar, as Special Master, with the duty and authority to investigate the acts, conduct, property, liabilities, financial condition, books, records and assets of Eisenlohr: the circumstances relating to the offer of March 26, 1943 to the holders of 7% cumulative approved stock of the defendant, and other acts of the parties: the question whether there had been any violation of Rule X-10B-5 "Employment of Manipulative and Deceptive Devices" of the Securities and Exchange Commission: to take testimony and report to the Court (R. 13-15).

Eisehlohr then filed its petition in the Circuit Court of Appeals for the Third Circuit praying that a writ of mandamus be directed to the Trial Judge and to the other Judges of the Court requiring them to vacate the order (R. 1-42). After argument before the full court (five Judges) the said Circuit Court, on September 27, 1944, filed an opinion holding that the order of reference complained of should be set aside, but refrained from ordering the formal issuing of a writ of mandamus prayed for on the ground that it was unlikely that such action would be necessary (R. 127). Biggs, J. filed a dissenting opinion in which McLaughlin, J. concurred (R. 128-140).

Under date of November 13, 1944 the Trial Judge entered an order amending his order of June 9, 1943 (the order of reference under attack), the amendment consisting of striking out that portion of the order which made it the duty and power of the Special Master to investigate the question as to whether or not there had been any violation of Rule X-10B-5 of the Securities and Exchange Commission (App., p. 1).

Under date of January 23, 1945, the U. S. Circuit Court of Appeals for the Third Circuit caused a peremptory writ of mandamus to issue requiring the Trial Judge and the other Judges of the District Court to vacate, revoke, set aside, etc. the order of reference of June 9, 1943 (R. 141). This petition for certiorari followed.

Briefly stated, the majority opinion held that the matters referred to the Special Master were outside the scope of investigation of the Court and foreign to the litigation; and that Rule 23 (c) of the Federal Rules of Civil Procedure was not applicable. The dissenting Judges based their dissent upon the proposition that the order of reference was in aid of or ancillary to the original proceeding (R. 133); that the matters into which the Special Master was to inquire were ancillary to or closely connected with the issues in the pending case (R. 133); that a Judge of the District Court, sitting as chancellor, possesses power to investigate the circumstances under which parties to a pending litigation have compromised claims which were the subject matter of the suit pending (R. 134); and in general, that the order of reference was justified under Rule 23 (c), requiring the approval of the Court for a compromise in a class suit (R. 137).

The dissenting opinion also stated that if the Trial Judge has reason to believe that a compromise of the complainant's claims has been arrived at by fraud, by collusion, by deceit or by the withholding of pertinent information, he may not be accused of a breach of discretion if he investigates the circumstances of the compromise (R. 134); that a district court of the United States is empowered by Sec. 262 of the Judicial Code, 28 U.S.C.A. 377, to employ all writs necessary for the exercise of its jurisdiction in a pending cause; and that the Trial Judge in reality availed himself of the provisions of said section in making the order of reference complained of (R. 135).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, U.S.C. Title 28, Sec. 347). The judgment or order of the United States Circuit Court for the Third Circuit to be reviewed was entered January 23, 1945.

QUESTIONS INVOLVED.

1. Is not a District Judge's Order of reference to a Special Master, directing an inquiry into the circumstances surrounding an effectuated compromise of a class suit, interlocutory or discretionary in character, and such as may not be controlled or reviewed by a writ of mandamus in a Circuit Court?

2. Was not the order complained of proper in view of (a) the provisions of Rule 23 (c) of the Rules of Federal Procedure, and (b) the acts of the parties amounting to a compromise of the class litigation?

3. Was not the order complained of proper in view of the prayer for the appointment of a receiver and the allegations of fraud and domination in the complaint?

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

1. In issuing a peremptory writ of mandamus requiring and commanding the Trial Judge and the other Judges of the Court to vacate, revoke and set aside, etc. the order of reference to a Special Master, the Circuit Court of Appeals for the Third Circuit has decided a federal question in a way probably in conflict with the following applicable decisions of the Supreme Court of the United States:

Ex parte Wagner, 249 U. S. 465; 39 S. Ct. 317; 63 L. Ed. 709;

American Construction Co. v. Jacksonville T. & K.W.R. Co., 148 U. S. 372; 13 Sup. Ct. 758; 37 L. Ed. 486;

U. S. ex rel. Alaska Smokeless Coal Co. v. Lane, 250 U. S. 549; 40 Sup. Ct. 33; 63 L. Ed. 1135.

2. In holding the order of reference to a Special Master improper, the Circuit Court of Appeals for the Third Circuit has decided an important question of federal law which has not been, but should be, settled by the Supreme Court of the United States, to wit: the question whether a District Court judge may under the provisions of Rule 23 (c) of the Federal Rules of Civil Procedure, direct a Special Master to make an inquiry into the facts and circumstances surrounding a compromise which has been actually effectuated in a class suit, without submission for approval to the Trial Judge, through the medium of the purchase by the defendant corporation of the stock interests of the plaintiff and others in the class in the corporation.

3. The Judges of the Circuit Court of Appeals for the Third Circuit divided 3 to 2 in their opinion.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Third Circuit, sitting at Philadelphia, Pennsylvania, commanding that Court to certify and to send to this Court on a day certain to be therein named a full and complete transcript of the record and all proceedings had in this case, numbered and entitled on its docket OCTOBER TERM, 1943, No. 8412, to the end that this case may be reviewed and determined by this Court; that the said judgment of the United States Circuit Court of Appeals for the Third Circuit may be reversed by this Court; and that your petitioner may have such other and further relief in the premises as may seem just and proper.

And your petitioner will ever pray.

HIRSH W. STALBERG,
Attorney for Petitioner.

SUPREME COURT OF THE UNITED STATES.

Term, 1944.

No.

HARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,

Petitioner,

vs.

WEBSTER EISENLOHR.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW.

The Trial Judge wrote no opinion. The opinion of the Circuit Court (both majority and dissenting) appears in the record at pages 120-140 and is reported in the Advance Reports of the Federal Reporter, 2nd series, at 145 F. (2nd) 316.

JURISDICTION.

The grounds on which jurisdiction of this Court is invoked is set forth in the petition at page 9 thereof.

STATEMENT OF THE CASE.

The statement of the case appears in the Petition at pages 2 to 8, and in the interest of brevity is not repeated.

SPECIFICATION OF ERRORS.

The errors which petitioner will urge, if writ of certiorari be granted, are that the Circuit Court of Appeals for the Third Circuit erred:

1. In issuing the peremptory writ of mandamus dated January 23, 1945.

2. In holding that an interlocutory and discretionary order (of reference to a Special Master) of the District Court Judge is subject to review or control by mandamus in the Circuit Court.

3. In holding that Rule 23 (c) of the Rules of Civil Procedure does not justify an investigation (through the medium of a reference to a Special Master) in a class suit compromised, without submission for approval of the Trial Judge, by the medium of the defendant corporation's pur-

chase of the stock interests of the plaintiff and others in the class, at prices fixed by the defendant corporation, accompanied by misrepresentations as to the value of the stock and the financial condition of the defendant corporation, the failure to disclose material and relevant facts relating to the value of the stock thus purchased, and the payment of incredibly exorbitant "commissions" to counsel for the plaintiff for securing transfer of the stock from plaintiff and others in the class to the defendant corporation.

4. In holding that despite the prayer for the appointment of a receiver and the allegations of fraud and domination in the complaint, the reference to a Master was improper.

STATUTES INVOLVED.

No statute is involved, but Rules 23 (c) and 53 of the Federal Rules of Civil Procedure (28 U.S.C.A. following Sec. 723) are involved.

ARGUMENT.

INTERLOCUTORY, DISCRETIONARY ORDERS OF THE DISTRICT COURT ARE NOT SUBJECT TO CONTROL OR REVIEW BY MANDAMUS IN AN APPELLATE COURT.

An Order of reference to a Special Master is an interlocutory order:

> Grant v. Phoenix Mutual Life Insurance Company, 121 U. S. 118: 7 Sup. Ct. 849; 30 L. Ed. 909;

Deckert v. Independence Shares Corp., 311 U. S. 282; 61 S. Ct. 229; 85 L. Ed. 189, 195 Note 4;
Dooley v. Fritz, 45 F. (2nd) 317 (C.C.A. 1).

An Order of reference to a Special Master is discretionary with the Court:

In the Matter of Walter Peterson, 253 U. S. 300; 40 S. Ct. 543; 64 L. Ed. 919, 925;
Veneri v. Draper, 22 F. (2nd) 33 (C.C.A. 4);
53 C. J. page 700, Sec. 58;
4 C. J. page 256, Sec. 129.

Mandamus does not lie to control, review or reverse an interlocutory, discretionary order of the court below:

38 C. J. 656, Sec. 194;
Ex Parte Wagner, 249 U. S. 465, 39 S. Ct. 317; 63 L. Ed. 709;
American Construction Co. v. Jacksonville, T. & K.W.R. Co., 148 U. S. 372; 13 S. Ct. 758; 37 L. Ed. 486, 489;
In re Cohen, et al., 107 F. (2nd) 881 (C.C.A. 5);
National Bondholders Corporation v. McClintic, 99 F. (2nd) 595, (C.C.A. 4).

In ex parte Wagner, supra, this Court said at 63 L. Ed. 713:

"Mandamus is an extraordinary remedy, to be resorted to for the purpose of securing judicial action, not for determining in advance what that action shall be (Re Rice 155 U. S. 396, 39 L. Ed. 198, 15 Sup. Ct. Rep. 149). It may not be resorted to, as the petitioners seek to resort to it here, for the purpose of controlling minor orders made in the conduct of judicial proceedings, and the fact that the result of litigation may possibly be such that interlocutory proceedings taken may not prove of value is not a sufficient

reason for calling the writ into use for the purpose of forbidding such proceedings, *even though the cost of them cannot be recovered from the opposing party* or even though the order cannot be reversed on error or appeal. Ex parte Newman, 14 Wall. 152, 165, 168, 20 L. ed. 877, 879, 880. This from American Construction Co. v. Jacksonville T. & K.W.R. Co. 148, U. S. 372, 379, 37 L. ed. 486, 489, 13 Sup. Ct. Rep. 758, is sharply pertinent to the application before us:

" 'Least of all can a writ of mandamus be granted to review a ruling or interlocutory order made in the progress of a cause; for, as observed by Chief Justice Marshall, to do this "would be a plain evasion of the provision of the act of Congress that final judgments only should be brought before this Court for re-examination;" would "introduce the supervising power of this Court into a cause while depending in an inferior court, and prematurely to decide it"; would allow an appeal or writ of error upon the same question to be "repeated, to the great oppression of the parties"; and "would subvert our whole system of jurisprudence." (Italics supplied.)

It is clear, then, from the authorities cited that an order of reference to a Special Master is interlocutory and discretionary in nature, and in consequence mandamus does not lie in the Circuit Court to control, review, reverse or set aside the order.

THE ORDER COMPLAINED OF WAS JUSTIFIED AND PROPER UNDER THE PROVISIONS OF RULE 23 (c) OF THE FEDERAL RULES OF CIVIL PROCEDURE.

That rule provides as follows:

"A class action shall not be dismissed or compromised without the approval of the court. . . . If the

right is one defined in paragraphs (2) or (3) of subdivision (a) notice shall be given only if the court requires it." 28 U.S.C.A. following Sec. 723.

That the class action in the District Court *had* been compromised is not open to doubt.

It is perfectly true that the record does not show any formal agreement of compromise. Counsel for plaintiff in the District Court, however, several times stated that the litigation had been "settled" (R. 75); he stated that he no longer had a client (R. 74); and that Eisenlohr had bought out most of the outstanding preferred stock whose owners constituted the class interested in the litigation (R. 75).

Any contention that the litigation was not compromised by the purchase of these shares of preferred stock is disingenuous. The truth is that Eisenlohr had simply bought out the opposing litigants. It had bought out their stock at $150.00 a share (R. 35), although later it apparently thought it wise to redeem the unbought shares at the considerably higher price authorized by the charter (R. 136). The purchase from those stockholders who sold at $150.00 was accompanied by fraudulent misrepresentations and by the payment of what the dissenting opinion below called "astonishing commissions"—to whom? to counsel for the plaintiff and for others in the class.

A compromise need not be denominated as such to constitute a compromise. Let it be called what one will, a defendant's purchase of the corporate stock which alone gives the plaintiff the status to carry on the litigation as plaintiff is a compromise of the suit. Naturally, if no one remains to carry on the suit, the litigation must fall or be dismissed. This is what happened in the District Court litigation; and what happened brought the transaction directly within the terms of Rule 23 (c) supra.

That there was no motion for dismissal or compromise is without significance. The rule does not speak of a motion. It makes approval of dismissal or compromise mandatory;

in other words, a class suit *may* not be dismissed or compromised without approval.

The litigation in the District Court in this case *was* compromised without approval, and Rule 23 (c) implies a positive duty on the Trial Judge to give approval or withhold it. It is elementary that the Trial Judge is vested with whatever incidental or implied powers are necessary in order to exercise the expressed power of approval or disapproval. Among those incidental or implied powers must be included the power to investigate the circumstances surrounding the compromise. Any other interpretation or construction would shackle his hands. It would be idle to impose upon the Trial Judge the duty to approve a compromise if the means of learning the facts which he must have before he can exercise his judgment are withheld from him.

The facts in the District Court litigation could well be considered a classical illustration of the wisdom of Rule 23 (c). It is perfectly inferable from the record (and from any practical viewpoint it is the fact) that holders of preferred stock of the defendant Eisenlohr had been induced by misrepresentation and withholding of essential information to sell the stock back to the corporation at less than its value: i.e. had been thus induced to *compromise* the issue at a lesser figure than they should have received, and than they probably would have demanded, had proper disclosure and no misrepresentation been made.

Biggs, J. in the dissenting opinion below has pointed out (R. 135) how the preferred stockholders could have been (and undoubtedly were) misled by the defendant company's annual report for the year 1942 sent to stockholders on March 23, 1943.

The shocking factor which appeared in the company's efforts to purchase the preferred stock was the misleading statement in the annual report—the statement that the net earnings of some $235,000.00 for the year 1942, were equivalent to 49¢ per share on the common "after allowance for unpaid preferred dividends accrued" in 1942 (R. 27).

This amounted to a statement that the company had earned only $7.00 per share (the stipulated dividend) on the preferred stock for 1942. The statement was false. The company had earned almost $47.00 per share of preferred stock for 1942 ($235,751.73 divided by 5037) (R. 27, 49, 54). Common stock could not, of course, receive dividends until all arrearages of dividends on preferred had been paid; therefore, in cold fact, there were no earnings on the common "after allowance for unpaid preferred dividends".

Naturally, holders of preferred stock, who were informed by the company that their stock had earned only $7.00 per share for 1942, would be willing to sell the stock at a much lower price than if the truth had been disclosed to them—that the earnings were almost $47.00 per share, whether available for actual dividend payments or not.

Furthermore, earnings for 1943 were mounting still higher. The company made earnings in the *first quarter* of 1943 equivalent to $26.00 per share of preferred stock (R. 52). This fact, as shown, was not disclosed to the holders of the preferred stock.

Here was a company which, in the last fifteen months, had earned about $73.00 per share on the preferred—almost enough to wipe out the accumulated arrearages of dividends in the preferred in the amount of $82.25 per share. The preferred had brought suit to wrest control of the company from those elected and appointed by the common stockholders. What did the latter do?

They immediately embarked upon a plan to buy out all the preferred at $150.00 per share, although its redemption value was $197.25. They misrepresented the earnings on the preferred for 1942, and they failed to disclose the earnings for the first quarter of 1943. Everett Meyer, the president, commenced to buy large blocks of common stock. The company offered a lawyer, counsel for the plaintiff in the suit, a brokerage fee of *$750.00 per hundred share certificate* for any stock which he induced his clients to sell. This brokerage fee should be contrasted with the normal broker-

age figure of about *$35.00 per hundred share certificate*. Since counsel for the plaintiff had taken the position that he controlled or represented some 1200 shares of preferred, this meant that he would earn brokerage fees in the amount of some $9,000.00 for "assisting" the company to purchase the stock from those he represented or controlled.

Counsel for the plaintiff accepted the offer for brokerage fees, and the plaintiff, among others, sold his preferred stock.

Whether or not the circumstances concerning Eisenlohr's purchase of the preferred stock were an issue in the litigation at its inception or during its course, they certainly became issues when Eisenlohr began to work out the compromise and finally effectuated it. Accordingly, it was not only within the power of the trial judge to investigate those facts (so that he might exercise the duty imposed upon him of approval or disapproval), but it became his *duty* to investigate those facts. Since such investigation would be futile without an examination of the financial resources and status of the defendant corporation, which involved complicated figures and accountings, it was proper under Rule 53 to refer those issues to a Special Master, under well settled rules of law.

The petitioner in this Court contends, therefore that—passing by the power of the Circuit Court to control the referral to a Special Master by mandamus—the order of reference was nevertheless proper, justified and necessary.

THE ORDER WAS JUSTIFIED BY THE PRAYER FOR A RECEIVER AND THE ALLEGATIONS OF FRAUD AND DOMINATION IN THE COMPLAINT.

At the time the order of reference was made the suit had been compromised, but not dismissed. The Bill of Complaint still possessed vitality. Others in the class might intervene or join in the litigation. The complaint averred

that the Chase National Bank of New York through its ownership of a large block of common stock dominated and controlled the defendant, Eisenlohr, and that the assets and property of the company were being managed, controlled and disposed of for the sole benefit of the holders of the common stock to the injury and prejudice of the preferred stockholders.

At the time of the order of July 9th, there were still holders of preferred stock. If it developed that the averments of the complaint were true, there was still suffering from the acts complained of and it was still possible that the situation called for the appointment of a receiver. The matters which the order of reference required the Special Master to investigate and report upon were also germane to the question of such an appointment, as well as to the question of a compromise. Accordingly, from that viewpoint there was still entire justification for the order of reference.

APPLICABLE EXCERPTS FROM THE DISSENTING OPINION BELOW.

> "On the question of possible abuse of the court's discretion, referring specifically to the conduct of Webster Eisenlohr, Inc., I think it is apparent that that company's annual report for the year 1942, sent to stockholders on March 23, 1943, was lacking in candor. A preferred stockholder, unversed in corporate law, might have gathered from the report that despite the fact that the company had a net operating profit for the year 1942 in excess of $235,000, a sum sufficient to reduce the arrearage of accumulated dividends on the preferred stock by approximately 75%, only the sum of $7 per share was immediately available for the preferred stockholders, the balance being allocable to the common stock." (R. 135.)

"It appears also that Webster Eisenlohr, Inc. paid the sum of $750 per 100 share certificate to the plaintiff's attorney for the preferred stock which his clients, or those with whom he got in contact, sold to the company. This is an astonishing commission; more than 2,000% above that permitted to a broker on a regulated exchange. The brokerage house acting for the company also received a fee of $10,000 as compensation for its efforts in acquiring preferred stock for the company. It does not appear that the nature and extent of the brokerage fees were made known to the preferred stockholders. The consideration of these items might well have lead Speese and the preferred stockholders associated with him in his litigation to hold their stock for higher prices." (R. 136.)

"While no motion for the compromise, settlement or dismissal of Speese's suit has been filed in the District Court, it is clear that if all of the preferred stock has been purchased or redeemed by the company, the case has in fact been compromised and is ripe for dismissal." (R. 137.)

"If the court is to approve the compromise it is necessary that the court be informed fully as to the circumstances of the compromise. The court, therefore, is entitled to make use of the instrumentality of a master to inform itself in the premises. For these reasons the District Court now is entitled to make an order of reference to a master similar to the order complained of. It follows that the appellate tribunal should not issue a writ of mandamus to compel the District Court to vacate its existing order." (R. 137.)

"Since the complainant prays for the appointment of a receiver and alleges that the property of the corporation has been used for the benefit of the common stockholders in derogation of the rights of the preferred stockholders, the court was entitled to make use of a master in order to advise itself in the premises. See

Ex parte Peterson, 253 U. S. 300; In re Utilities Power & Light Corporation, 90 F. (2nd) 798, 800." (R. 133.)

Petition in this Court therefore contends that

(a) The Court below erred in issuing the Writ of Mandamus directing the Trial Judge and the other Judges of the District Court to set aside the order of reference, since mandamus does not lie to control, review or reverse an interlocutory and discretionary order (such as an order of reference).

(b) The order of reference was necessary and required both under Rule 23 (c) and because of the prayer for the appointment of a receiver and the averments of fraud and domination in the complaint.

(c) The order of the Court below constituted by the peremptory Writ of Mandamus should be reversed.

Respectfully submitted,

HIRSH W. STALBERG,
Attorney for Petitioner.

Appendix

ORDER AMENDING ORDER OF JUNE 9, 1943.

AND NOW, to wit, this 13th day of November, 1944, the Order made by this Court June 9, 1943 is amended as follows:

1. That David Bortin, Esq., of Philadelphia, Pennsylvania, is hereby appointed Special Master in the above-entitled cause under Rule 53 of the Rules of Civil Procedure, with the duties and authority set forth below.

2. Said Special Master is hereby directed to investigate: the acts, conduct, property, liabilities, financial condition, books, records and assets of the Defendant; all the circumstances relating to an Offer made March 26, 1943 to the Holders of 7% Cumulative Preferred Stock of the Defendant; the arrangement made by and between the Defendant with White, Weld and Co. of New York and Bertram K. Wolfe, Esq. with reference to the Offer made to the Preferred Stockholders; the conduct of the Board of Directors of the Defendant with reference to the making of said Offer to the Preferred Stockholders; the propriety, reasonableness and adequacy of the said Offer to the Preferred Stockholders; and any other matters which may be referred to the Special Master by the Court as relevant to these proceedings.

3. Said Special Master shall, at the earliest date practicable, prepare and submit a report of the foregoing investigation and recommendation to the Court. Said Special Master shall further prepare a summary of such report and recommendation in such manner as the Court shall direct and the same shall be submitted to the creditors and stockholders of the Defendant.

4. Said Special Master is authorized to examine the Di rectors and Officers of the Defendant and any other wit nesses concerning the foregoing matters or any of them.

5. Said Special Master is directed to report to the Cour any facts ascertained by him pertaining to fraud, mis conduct, mismanagement and irregularities in the conduc of the affairs of the Defendant and/or the Offer to the Pre ferred Stockholders.

6. Said Special Master may, upon further order of th Court, employ such person or persons as the Court may deem necessary for the purpose of assisting the said Specia Master in performing the duties hereby imposed upon hi

7. Said Special Master shall give at least 10 days' notic of his appointment, of the matters referred to him, and o the time and place fixed by him of a hearing thereon, b publication in the Legal Intelligencer and one newspape published in Philadelphia, Pennsylvania and one newspape published in New York, New York, and by notice mailed t the Preferred Stockholders of the Defendant and to th parties to this cause of their address of record.

8. IT IS FURTHER ORDERED that the reasonabl expenses and compensation of the Special Master shall b charged against the parties in such proportion and in suc manner as the Court may at the conclusion of the case, i its discretion, determine and order.

By the Court,
KALODNER,
J.

(18)

FILED
MAY 11 1945
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 1187.

LARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,
Petitioner,

vs.

WEBSTER EISENLOHR, INC.,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

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Petitioner,

vs.

WEBSTER EISENLOHR, INC.,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

Opinion Below.

The opinion of the Circuit Court of Appeals (R. 120-140), in an original proceeding in that Court, is reported in 145 F. (2d) 316.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of

February 13, 1925, **but the petition was not filed in time** (see page 7, *infra*).

The decree of the Circuit Court of Appeals was made and entered December 28, 1944 (R. 140-141). The petition was not filed until April 21, 1945, more than three months thereafter.

Questions Presented.

The decree of the Circuit Court of Appeals directed the issuance of (1) a writ of mandamus directing the Hon. Harry E. Kalodner, District Judge, to vacate an order of reference to a Special Master in a matter entitled *Speese* v. *Webster-Eisenlohr, Inc.* and (2) a writ of prohibition enjoining said Special Master from proceeding under the order of reference. The questions here presented are:

1. Was the petition timely?

2. Did the District Court in the *Speese* case have jurisdiction to deal with the matters it attempted to refer to a Special Master?

3. Were mandamus and prohibition proper remedies to prevent the District Court from exceeding its jurisdiction by an interlocutory order of reference?

Statement.

This is an original proceeding which respondent, Webster-Eisenlohr, Inc., instituted in the Circuit Court of Appeals for the issuance of (1) a writ of mandamus directing the Hon. Harry E. Kalodner, District Judge, to vacate an order of reference to a Special Master, dated June 9, 1943, in a matter pending before the District Court entitled *Speese* v. *Webster-Eisenlohr, Inc.*, and (2) a writ of prohibition enjoining said Special Master from taking any

proceedings under said order of reference. These writs were sought on the ground that the District Court was wholly without jurisdiction of the matters covered by the order of reference (R. 1a-11a).

In the complaint in said case of *Speese* v. *Webster-Eisenlohr, Inc.*, the plaintiff alleges, in essence, that he is the owner of ten shares of preferred stock of the defendant (respondent in this Court), Webster-Eisenlohr, Inc., on which dividends have remained unpaid for a number of years; that the action is brought on behalf of all the preferred stockholders of defendant; the defendant's outstanding capital stock consists of 5,132 shares of preferred stock and 409,313 shares of common stock; that under defendant's Charter and By-Laws the preferred stock was not entitled to participate in the management unless two quarterly dividends were in arrears, in which event "full voting power shall be vested in the preferred stock"; that at the annual meeting of defendant's stockholders on March 10, 1942, the preferred stock was allowed to vote along with the common stock rather than to the exclusion of the common stock; and that under the Charter and By-Law provisions above quoted the preferred stockholders are entitled to exclusive voting power, to the exclusion of the common stock (R. 15a-19a). The complaint also contains conclusory allegations that defendant is dominated by The Chase National Bank of the City of New York through its ownership of a large block of common stock, and that the control and management of the defendant have been usurped by the holders of the common stock (R. 18a-19a). The relief sought is a declaration that the preferred stock has "exclusive voting power", so long as two quarterly dividends remain unpaid, and the appointment of a receiver pending "determination of the issues herein" (R. 19a).

Defendant's answer put in issue plaintiff's ownership of preferred stock. It admitted the allegations as to the provisions of its By-Laws, the non-payment of preferred stock dividends, the voting procedure followed at the annual stockholders meeting, its capitalization, assets and liabilities, but denied the remaining allegations of the complaint (R. 21a-25a).

The only issues thus before the District Court were (1) plaintiff's ownership of preferred stock and (2) the proper construction of the quoted phrase "full voting power" as used in defendant's Charter and By-Laws.

The complaint, although verified October 15, 1942 (R. 20a) was not served until February 1, 1943 (R. ii), shortly before the usual date for the annual meeting of respondent's stockholders.

At a preliminary hearing before Judge Kalodner on March 2, 1943, plaintiff's counsel, in open court, disclaimed any charge of fraud or mismanagement against respondent in these words: "Your Honor please, I am not pressing here, or saying, or alleging that I can prove at this time any fraud or mismanagement" (R. 44a).

On March 26, 1943, during pendency of the action, respondent, *pursuant to discussions initiated before the commencement of the suit*, mailed to *all holders* of its preferred stock a written offer to purchase their shares at $150 per share, flat (R. 4a, 34a, 113a). This offer was mailed only three days after respondent had mailed to all its stockholders, both common and preferred, its annual report for 1942 (R. 4a). This annual report set forth, clearly and in detail, the amount of preferred stock outstanding, its par value, its redemption value *and the accrued dividends, and also respondent's earnings for the year* (R. 31a).

With this information before them, holders of 4,047 out of 5,037 outstanding shares of respondent's preferred

stock accepted said offer (R. 35a). Included in the shares accepting the offer were plaintiff's ten shares, *which he apparently had disposed of* because they were turned in, under the offer, by a third party (R. 4a).

Although respondent's offer was made to *all* its preferred stockholders, not just to plaintiff, and was accepted by more than 80% of them,[1] including a Mr. Cullman, who, for years, was respondent's chief executive officer, and a Mr. Cohen who, for years, was a director, and although the offer was made after the commencement of the action and was not referred to in or complained of by any pleadings or other papers in the action or by any stockholder, creditor or other person interested in respondent, Judge Kalodner requested information concerning the offer. As a matter of courtesy respondent's counsel furnished such information to him (R. 113a-118a). Upon the basis of this information, and although no one had complained of the offer, Judge Kalodner took occasion to charge, in open court, upon a hearing on plaintiff's application for a continuance, that the offer was fraudulent (R. 53a, 55a, 58a, 62a-66a).

Thereafter, on May 24, 1943, when the matter came before Judge Kalodner upon a postponed hearing, plaintiff's counsel, in seeking a continuance advised Judge Kalodner that plaintiff no longer owned any stock and was not prepared to proceed with the case, that anyone else could be substituted to prosecute the case "but nobody wants to, as far as I know" (R. 74a-75a).

On June 9, 1943, Judge Kalodner, on his own motion, appointed one David Bortin, Esq., Special Master to make an *investigation* of respondent, its finances, and its offer to its preferred stockholders, and also to investigate whether

[1] Subsequently, the remaining outstanding preferred stock was redeemed (R. 136-137), so that none of the preferred stock is now outstanding.

there had been any violation of Rule X-10B-5 of the Securities and Exchange Commission relating to fraudulent and manipulative devices. The Master was directed to report not only to the District Court but also to the Securities and Exchange Commission and to the parties, and also to submit a summary of his report to respondent's creditors and stockholders (R. 13a-15a).

It will be seen that Judge Kalodner did not appoint a Special Master in the usual sense to take testimony and report, but that he ordered an investigation, rather than a judicial hearing, by the Special Master, as an arm of the Court. Moreover, said investigation was directed to matters which were not within the issues of the case before Judge Kalodner, and *of which no complaint had then or has since been made by anyone other than Judge Kalodner.*

Respondent moved to vacate the order of reference on the grounds, among others, that the matters referred were not within the issues of the case, that the investigation ordered was not a judicial function, and that no dismissal or compromise of the action was sought within Rule 23(c) of the Rules of Civil Procedure (R. 38a-39a, 85a). This motion was denied by Judge Kalodner (R. 97a).

Respondent then petitioned the Circuit Court of Appeals for writs of mandamus and prohibition directing the District Court to vacate the order of reference and prohibiting the Special Master from proceeding thereunder (R. 1a-12a). The matter was argued before three judges of the court below, and subsequently, by direction of the court, was reargued before the court sitting *en banc* (R. 119). On September 27, 1944, the Circuit Court filed its opinion (R. 120-127), two judges dissenting (R. 128-140), holding that the matters referred to the Special Master were not within the issues of the action (R. 124-126); that the District

Court could not do through a Special Master what it could not do directly (R. 124-125); that the investigation ordered was not the exercise of a judicial function (R. 126); that no dismissal or compromise of the action was involved under Rule 23(c) of the Rules of Civil Procedure (R. 126-127); and that respondent was entitled to the writs sought (R. 123). The Court stated in its opinion that it was "unlikely that the formal issuing of the writs prayed for will be necessary" (R. 127).

On December 28, 1944, the Circuit Court of Appeals made and caused to be entered its decree directing the issuance of the writs prayed for (R. 140-141).

On January 24, 1945, pursuant to said decree, the Clerk of the Circuit Court of Appeals issued said writs (R. 141-144). On March 3, 1945, within the time for filing a petition for certiorari, the Circuit Court of Appeals entered an order staying the execution of the writs of mandamus and prohibition pending application for certiorari (R. 145).

ARGUMENT.

I.

The petition was filed too late.

The decree of the Circuit Court of Appeals, directing the issuance of writs of mandamus and prohibition, was made and entered December 28, 1944 (R. 140-141). The petition for certiorari was not filed until April 21, 1945, more than three months after entry of said decree. This Court is therefore without jurisdiction. *Department of Banking* v. *Pink*, 317 U. S. 264, 268 (1942); *Toledo Co.* v. *Computing Co.*, 261 U. S. 399, 418 (1923).

Petitioner has apparently assumed that the time for filing the petition did not begin to run until the issuance and service of the writs of mandamus and prohibition on January 24, 1945. But said writs were not, and do not purport to be, judgments or decrees of the court below. They were mere ministerial acts performed by the Clerk of that Court pursuant to the Court's final determination, set forth in its decree of December 28, 1944, that respondent's right to such writs had been established.[2] It is the correctness of this determination of the court below which petitioner seeks to have this Court review, not the acts of the Clerk of that Court in issuing the writs.

In *Department of Banking* v. *Pink*, 317 U. S. 264 (1942), the New York Court of Appeals, on June 18, 1942, affirmed a judgment and issued its remittitur to that court, which entered judgment on said remittitur on June 25, 1942. Thereafter, on July 29, 1942, the Court of Appeals amended its remittitur and on December 16, 1942, the lower court entered its judgment on the amended remittitur. A petition for certiorari filed October 20, 1942,—more than three months after the Court of Appeals issued its original remittitur—was denied as too late. This Court there said that the time for filing the petition ran from the entry of the judgment of the Court of Appeals which finally determined the case, leaving nothing to be done by the lower court "except the ministerial act of entering judgment on the remittitur";[3] and that the motion to amend the original remittitur did not extend the time for filing the petition

[2] It should be noted that the writs of mandamus and prohibition which were issued on January 24, 1945, themselves recite that they were issued pursuant to order of the Circuit Court of Appeals "entered" on December 28, 1944 (R. 142, 144).

[3] Cf., *Medhurst* v. *S. S. "South American"*, 264 U. S. 587 (1924); *Warshauer* v. *Lloyd Sabaudo*, 293 U. S. 610 (1934); and *Cahill* v. *Mayflower Bus Lines, Inc.*, 296 U. S. 629 (1935); also discussion of foregoing cases in Robertson & Kirkham, "Jurisdiction of the Supreme Court of the United States", page 775, footnote 29.

since said motion did not seek "a reargument or rehearing of any part of this case."

Writs of mandamus and prohibition are no more judgments or decrees than are writs of execution. Like writs of execution, they do not finally determine anything. They merely reflect and implement a prior determination of the court that the right to the writ involved has been established. *Cf. Wayman* v. *Southerd*, 10 Wheat. 1, 23 (1825).

The only judgment or decree of the Court below which is involved here was that entered December 28, 1944. Petitioner's time to apply for a writ of certiorari ran from that date. Accordingly, the petition was filed too late.

II.

Wholly apart from the fact that the petition was filed too late, this Court, in the exercise of its discretion, should deny the same.

No clearer case of an untimely petition could be presented. However, in view of the unfounded charges of fraud made against respondent by Judge Kalodner, it is appropriate to point out that, apart from the jurisdictional defect, the petition should be denied because the decision of the court below is clearly correct, there is no conflict of decisions, and the petition presents no issue of general importance.[4]

---

[4] Judge Kalodner's unfounded charges of fraud against respondent are in no way germane to the issues before this Court and hence will not be discussed in the body of this brief. Since, however, such charges of fraud were made by a District Judge, although no alleged victim, or in fact anyone other than the District Judge has asserted any fraud, *and since a minority of the court below took cognizance of such charges despite the fact that said court had refused to hear respondent's counsel thereon* (see R. 126), we deem it appropriate, and a matter of simple justice to respondent, to demonstrate to this Court that such charges of fraud are wholly groundless. We do this in the Appendix, pp. 15-20, *infra*.

The sole issue before the District Court in the *Speese* case (aside from the question of plaintiff's ownership of preferred stock) was whether the preferred stockholders were entitled, under respondent's Charter and By-Laws, to *exclusive* voting power so long as two quarterly dividends remained unpaid. Pending the action, respondent made an offer to *all* the holders of its preferred stock, not merely to plaintiff, to purchase the same; and pursuant to such offer respondent acquired 4,047 of its outstanding 5,037 shares of preferred stock, including the 10 shares which had been registered in the name of the plaintiff, Speese. When Judge Kalodner was advised of these facts, through information made available, at his request, by respondent, Judge Kalodner charged in open court that the offer to purchase said stock was fraudulent (R. 53a, 58a, 62a-66a), although no such charge had been made by any preferred stockholder or anyone else; and thereafter, on June 9, 1943, on his own motion, Judge Kalodner referred the case to a Special Master to make an investigation of respondent, its finances and its offer to its preferred stockholders, and also as to whether there had been any violation of Rule X-10B-5 of the Securities and Exchange Commission relating to fraudulent and manipulative devices. The Master was directed to report not only to the District Court but to the Securities and Exchange Commission and to the parties and to submit a summary of his report to respondent's creditors and stockholders (R. 13a-15a).

The Circuit Court of Appeals held that the order of reference was wholly beyond Judge Kalodner's jurisdiction, stating (R. 123-124):

> "The fundamental proposition which probably no one would dispute is that a court's power is judicial only, not administrative nor investigative. A judgment may only be properly given for something

raised in the course of a litigation between the parties [Footnote, citing cases, omitted]. Now, what was the litigation in this case? The complaint presents the question of the legal effect of the provision that preferred stockholders, under given circumstances, shall have full voting power. Whether full voting power means that they may vote along with holders of shares of the common stock or whether 'full' as used in the certificate of incorporation means 'exclusive' is a question of interpretation of language to be made with such help as the Pennsylvania decisions give, since the corporate litigant is a Pennsylvania corporation. * * *

"If the plaintiff's contentions on voting rights are upheld as a matter of law, the preferred stockholders are entitled to determine who shall manage the corporation, and other questions which may be determined by stockholders. They are entitled to court help to get those rights if they need it. On the other hand, if the plaintiff's contentions as to the meaning of the phrase are incorrect, they have alleged no legal grounds for complaint. While a receiver was asked for, it was simply in connection with the relief to be given the plaintiff, based on the correctness of this theory of his voting rights. No one disputed the solvency of the corporation.

"*The directions given the Master went far beyond anything involved in the issues presented in the litigation,* * * *." (Italics supplied.)

This decision is clearly correct. It is firmly established that under Article III, Sections 1 and 2, of the Constitution, district courts are limited to the exercise of "judicial power", and that such judicial power extends only to cases or controversies, and is capable of application only when a question is submitted *by a party* who asserts his rights in the form prescribed by law. *Osborn* v. *U. S. Bank,* 9 Wheat. 738, 819 (1824); *Ex parte State of Oklahoma,* 37 F.

(2d) 862 (C. C. A., 10th, 1930); 45 F. (2d) 1019 (C. C. A., 10th, 1930); 2 *Story on the Constitution,* Section 1646 (3rd Ed., 1858); and 2 *Watson on the Constitution,* 1088 (1910). In line with this principle it is settled that district courts cannot adjudicate matters which are not tendered by the pleadings before them, and that any attempt on their part to do so is without legal effect and is void. *Reynolds* v. *Stockton,* 140 U. S. 254, 266, 270-271 (1891); *Barnes* v. *Chicago &c. Ry.,* 122 U. S. 1, 14 (1887); *U. S.* v. *Goldstein,* 271 Fed. 838, 845 (C. C. A., 8th, 1921); *Osage Oil & Refining Co.* v. *Continental Oil Co.,* 34 F. (2d) 585 (C. C. A., 10th, 1929); *J. P. Jorgenson Co.* v. *Rapp,* 157 Fed. 732 (C. C. A., 9th, 1907); *Munday* v. *Vail,* 34 N. J. L. 418 (1871).

Petitioner asserts, however, that the order of reference was an interlocutory and discretionary order and that mandamus does not lie to control a discretionary order. That is generally true when the exercise of discretion is within the limits of the court's jurisdiction; but mandamus and prohibition are always available to prevent a lower court from exceeding its power or jurisdiction, without regard to the manner in which such excess of power or jurisdiction is attempted. Thus, in *In re Winn,* 213 U. S. 458 (1909), this Court said (p. 467):

> "The respondent, however, insists that mandamus will not lie to control the judgment or judicial discretion of the court to which the writ is proposed to be directed. This is true where the judgment or judicial discretion is within the limits of jurisdiction, but not otherwise."

It has been specifically held that mandamus is applicable to orders of reference which exceeded the Court's jurisdiction. *Ex parte Northern Pacific Ry. Co.,* 280 U. S. 142 and 530 (1930); *Grable* v. *Killits,* 282 Fed. 185 (C. C. A., 6th, 1922), cert. den., 260 U. S. 735 (1923); see also: *Los Angeles Brush Corp.* v. *James,* 272 U. S. 701 (1927); *Ex*

parte Peterson, 253 U. S. 300 (1920); *Simkins, Federal Practice*, Sec. 498 (1938).

Petitioner further asserts that the decree of the court below violates Rule 23(c) of the Rules of Civil Procedure, which provides that "A class action shall not be dismissed or compromised without the approval of the Court". That rule was intended to prevent one member of a class from prejudicing the rights of other members of a class by compromising or dismissing an action without notice to them. No such situation is presented here. The case of *Speese* v. *Webster-Eisenlohr, Inc.* has not been dismissed (R. 6a) and, as pointed out by the court below (R. 127), it cannot be dismissed without approval of the District Court. Nor has said case been compromised. Respondent made no arrangements whatever with the plaintiff Speese looking to the termination or settlement of said action. Its offer to purchase the preferred stock was made to *all* holders of preferrd stock, and the persons then owning plaintiff's stock merely took advantage of such offer.

Furthermore, nothing was done to change in any way the rights of any members of the class (*i. e.*, the preferred stockholders). The question as to whether, under respondent's Charter and By-Laws, the preferred stock had the right to vote together with the common stock, or whether it had the exclusive right to vote, was still pending before the District Court after, as well as before, respondent made its offer to its preferred stockholders. Any other preferred stockholder could have intervened in the action (and respondent stipulated not to oppose any such intervention—R. 127), and continued the litigation. The preferred stockholders who had not accepted the offer and turned in their stock were so advised (R. 35a-36a), but none has ever sought to intervene.

Whenever the point has arisen, the District Courts have held that a purchase of stock does not constitute a "com-

promise" of the action within the meaning of Rule 23(c), *Malcolm* v. *Cities Service Co.*, 2 F. R. D. 405 (1942); and that until application is made to the court for compromise or dismissal there is nothing for the court to act on, *Heesch* v. *Pittsburgh Steel Co.*, 40 F. Supp. 243 (1941).

Finally no statute or rule can confer on district courts the investigatory powers sought to be bestowed by the order of reference. As heretofore indicated, under the Constitution district courts are limited to the exercise of judicial powers.

It is unnecessary to refer to any of the cases cited by petitioner because mere inspection thereof will show that none of them is in any way in conflict with the decision of the court below.

Conclusion.

The petition for a writ of certiorari should be denied because it was filed too late. Apart from this jurisdictional defect, the petition should be denied because the decision of the court below is clearly correct, and there is no conflict of decisions or other ground justifying certiorari. Moreover, the petition arises on peculiar facts which in no event can involve issues of general application.

Dated: May 10, 1945.

Respectfully submitted,

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Appendix.

Judge Kalodner's charges of fraud are groundless. Had they been made by one holding a less responsible position than his they might well be ignored.

Respondent, a Pennsylvania corporation, engaged in the manufacture of cigars, had outstanding 5,037 shares of 7% cumulative Preferred Stock (R. 27a, 31a).

During the years of the depression, respondent's operations were unprofitable and no dividends were paid on its preferred stock after April, 1931 (R. 16a). At the end of the year 1942, the accumulated dividend arrears amounted to $82.25 per share (R. 31a).

By 1940 an operating deficit of approximately $921,000 had accumulated and while respondent had an earned surplus applied to preferred stock retirements (such retirements having been made prior to the depression) of over $1,000,000, respondent, because of charter restrictions, could not use this surplus to offset the deficit.

Beginning with 1940, respondent's operations began to be profitable and by the end of 1942 its deficit had been reduced to $268,955.15 (R. 31a).

In May, 1942, almost a year prior to the commencement of the *Speese* suit, respondent's directors appointed a committee to consider ways of funding or otherwise retiring the preferred stock and accumulated dividends. Several plans were considered, one of which was to offer new $5 preferred shares for the old shares in the ratio of 1¾ new shares for each old share plus accumulated dividends, but when this plan was taken up with Mr. Cullman, who for many years had been respondent's chief executive officer and a director, and with Mr. Cohen, a director for a number of years, who, together, owned more than one-half of respondent's preferred stock, they indicated that for tax reasons they could not accept it (R. 69a-70a, 113a-114a).

Discussions were then had looking toward a purchase of respondent's preferred stock for cash and Messrs. Cullman and Cohen advised that they and certain interests affiliated with them, which owned preferred shares, would

accept $150 per share, flat, for their stock. Respondent then consulted its own bankers and other bankers and was advised that in view of respondent's progressive business improvement, arrangements for such a purchase could be made without impairing respondent's capital position or bank credit. Thus assured of the cooperation of the largest holders of its preferred stock, and of the feasibility of the proposal, respondent arranged that Messrs. White, Weld & Co. would acquire all shares which were offered at this price, taking care of the necessary checking of transfer papers and the like, and would hold the shares for 120 days, by the end of which time, respondent would acquire them at the same price. For its services, Messrs. White, Weld & Co. were to be paid $10,000 plus actual carrying charges not exceeding 1% per annum on monies expended (R. 69a-70a, 114a).

Respondent and Messrs. Cullman and Cohen all felt that if any such purchase of preferred shares was to be made, each preferred stockholder should have the opportunity of disposing of his shares at the same price (R. 114a).

While these discussions and negotiations were under way, plaintiff Speese, on February 1, 1943, served his complaint in the *Speese* action. Bertram K. Wolfe, Esq., attorney for plaintiff Speese, advised that he also represented other holders of preferred stock with holdings aggregating about 1,200 shares. Thereupon, Mr. Wolfe was invited to consider the aforesaid plan which respondent had worked out for the purchase of preferred shares. Mr. Wolfe was advised fully of how the proposed plan had originated and developed and was asked to say whether he considered the price offered a fair one. He said he considered the price fair and would advise those shareholders he represented to accept it and would assist in submitting the offer to them, but that he wanted the price of $150 per share to be net to them, *i.e.*, he wanted respondent to pay his compensation for his services in submitting the offer and in representing plaintiff in the *Speese* suit (R. 114a).

The figure Mr. Wolfe first mentioned for his compensation was considered much too high by respondent, which pointed out that it had nothing except Mr. Wolfe's statement to show he represented anyone other than Speese. Mr. Wolfe met this point by agreeing to supply a list showing the names, addresses and holdings of the preferred stockholders he represented, and it was finally arranged that respondent would pay him at the rate of $7.50 per share for each share on that list which accepted the offer. Such compensation was to be in lieu of any other compensation to Mr. Wolfe and of any allowance to him by the Court in the *Speese* suit (R. 112a-113a).

Respondent considered this arrangement with Mr. Wolfe advantageous. In the course of the *Speese* suit, although no evidence had been received and no argument on the merits of that suit had been heard, Judge Kalodner had stated that he thought plaintiff's position as to the meaning of "full voting power" sound. Although subsequently he had stated that his expression of opinion was not to be taken as final,[1] nevertheless, respondent and its counsel could not ignore this evidence of Judge Kalodner's initial impression in the matter and were aware that if the *Speese* suit was decided in favor of plaintiff's contentions, a substantial allowance to Mr. Wolfe would undoubtedly be made by the Court. The aforesaid arrangement relieved respondent from the risk of a large allowance to Mr. Wolfe.

There was no agreement or understanding with Mr. Wolfe as to plaintiff's shares or the shares of any other stockholder represented by Mr. Wolfe except that Mr. Wolfe was to submit the offer to them and advise them that in his opinion it was fair and should be accepted.

After the foregoing arrangements, the offer in question was made to all respondent's preferred stockholders on March 26, 1943.

Judge Kalodner's charge of fraud appears to be based primarily on a statement contained not in respondent's

[1] Although the statements referred to are not included in the abbreviated record before this Court, a reference to them will be found at page 67a of the record.

offer but in its annual report for the year 1942 which was mailed to stockholders three days prior to the mailing of the offer. There respondent's profit for the year was stated to be equivalent to 49¢ per share of common stock after deduction of estimated taxes and after allowance for unpaid preferred dividends accrued in that year, as compared with 38¢ per share for the year 1941. The crux of Judge Kalodner's complaint seems to be that a similar arithmetical calculation was not made to show what respondent's earnings for the year 1942 were equivalent to per share of preferred stock (R. 49a-50a, 54a, 56a, 64a).

Respondent's annual report, however, contained the following information (R. 31a):

"CAPITAL

Capital stock:		
Preferred, 7 per cent. cumulative, par value $100 per share (redeemable at $115 per share and accrued dividends); authorized 15,037 shares, issued and outstanding 5,037 shares (cumulative dividends unpaid since April 1, 1931, amount to $82.25 per share	$ 503,700.00	
Common, authorized 500,000 shares, no par value, issued and outstanding 409,313 shares	409,313.00	
	913,013.00	
Surplus appropriated for preferred stock retired ($1,326,300.00 from capital surplus)	2,496,300.00	
Capital surplus	634,265.01	
Deficit from operations	*268,955.15*	3,774,622.86
		$4,314,495.64

* * * *

Net operating profit for the year	$ 235,751.73"

From the foregoing, it is apparent that preferred stockholders were fully advised as to the present status of their shares and if any wished to determine what respondent's net operating profit for the year was equivalent to per

share of preferred stock, he had only to divide that profit of $235,751.73, which was set forth in the report, by the number of shares outstanding, namely, 5,037, which was also set forth in the report. This was a simple arithmetical calculation which any stockholder could easily have made.

Judge Kalodner also appears to have felt that preferred stockholders should have been advised that their rights were prior to the rights of common stockholders (R. 57a-58a). But the very statement quoted above gave them the dividend rate, advised them that the dividends were cumulative, and amounted to $82.25 per share. That the preferred stock was prior to the common stock was apparent from its name as well as from each preferred stock certificate which contained a statement of the prior rights of the preferred stock.

Judge Kalodner also criticized the offer because it did not set forth, in detail, respondent's arrangements with White, Weld & Co. and with Mr. Wolfe. The offer did set forth, however, in so many words, that both would be compensated by respondent for their services. Messrs. Cullman and Cohen and Mr. Wolfe knew the detailed arrangements which had been made. Other stockholders, if interested in the details, could easily have inquired.

It is significant that Messrs. Cullman and Cohen, both long associated with respondent in the most responsible positions and who were intimately familiar with respondent's business and fully advised as to all the arrangements made by respondent in connection with its offer to its preferred stockholders, accepted the offer for the shares they owned. They could not have been defrauded. They knew as much about respondent's business, its history and its future prospects, and about its offer to its preferred stockholders, as anyone knew. With all this information they accepted the offer.

It is also of significance that despite the fact that Judge Kalodner's charges received considerable newspaper publicity and that Mr. Wolfe notified respondent's remaining preferred stockholders of the pendency of the suit, of the fact that plaintiff had disposed of his shares, and of the

possibility that remaining preferred stockholders might wish to intervene and prosecute the suit, no one, even to this day, has sought to intervene. In fact, respondent has not even received a complaint from anyone, anywhere, at anytime, concerning the offer in question, except, of course, the complaint made by Judge Kalodner in the *Speese* suit, where no issue as to the offer was before him.

Were there any basis for the charges made by Judge Kalodner, we may be sure such charges would have been asserted by some of the interested parties, particularly after the publicity which Judge Kalodner's criticism received.

Judge Kalodner also has made reference to purchases by Everett Meyer, president of respondent, of a large block of respondent's common stock in May, 1943. The fact is that this purchase was made by Mr. Meyer under an option received by him from a private party a year before. The option price was $3 per share and at the time Mr. Meyer purchased the stock its market price was about $6 per share, so that Mr. Meyer's reasons for making the purchase are obvious and entirely proper.

The foregoing facts are presented, although, as the Court below ruled, they probably are not relevant, because of the groundless and utterly uncalled-for charges of fraud gratuitously indulged in by Judge Kalodner and taken note of by the dissenting judges of the Court below, despite the fact that the Court had refused to hear counsel for respondent on the question (R. 126).

Although respondent was not called upon to answer, here, any charges of fraud because they are not germaine to this proceeding and were not germaine to the case before Judge Kalodner, nevertheless, for the reasons stated, we have deemed it proper to set forth the facts. Not only is fraud never presumed, but, we submit, the facts of this case demontrate, affirmatively, that respondent's actions were in all respects proper.

(19)

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Supreme Court of the United States

October Term, 1944.

No. 1187.

HARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,

Petitioner,

vs.

WEBSTER EISENLOHR, INC.

PETITIONER'S ANSWER TO BRIEF FOR THE RESPONDENT IN OPPOSITION.

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IN THE

SUPREME COURT OF THE UNITED STATES.

October Term, 1944.

No. 1187.

HARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,
Petitioner,

vs.

WEBSTER EISENLOHR, INC.,
Respondent.

PETITIONER'S ANSWER TO BRIEF FOR THE RESPONDENT IN OPPOSITION.

The respondent argues that the Petition for Certiorari was filed too late, contending that the time for filing the petition runs from the date of the order of the court below filed December 28, 1944, and not from the date of the issue of the Writ of Mandamus on January 24, 1945. This argument of the respondent is based upon the ground that the Writ of Mandamus is not a judgment or decree of the court below, but that its issue is a mere ministerial act performed by the Clerk of the Court.

The petitioner now contends that the definitive order addressed to the Trial Judge by the court below was that contained in the Writ of Mandamus. The order of December 28, 1944 merely states that "it is now here ordered, adjudged and decreed by this court that the prayer of the said petition be, and the same is hereby granted; and the clerk of this court is hereby directed to issue the writs prayed for." (R. 140-141.)

No order was made upon the Trial Judge (petitioner herein) by said order of December 28, 1944. The Writ of Mandamus, however, specifically ordered the Trial Judge and the other Judges of the District Court to "vacate, revoke, set aside and declare null and void and of no effect said order of June 9, 1943...." (R. 142.)

It is therefore contended that the order directing or commanding the Trial Judge to do something: i.e. the order contained in the Writ of Mandamus, is a reviewable order.

To put it differently, the command in the peremptory writ implemented the order of December 28, 1944 and consequently became a reviewable order.

There is a difference between the ordinary writs which are merely ministerial acts of the clerks, and the peremptory writ of mandamus. A writ of summons is directed to the sheriff or the marshal—who is *not* a litigant—and commands him to serve process upon the litigant; a writ of execution is directed to a sheriff or marshal—who is *not* a litigant—and directs him to execute upon the property of a litigant.

The peremptory writ of mandamus, on the other hand, is *directed to a litigant* and *commands the litigant* to do something. Viewed in that light, it is similar to an order or decree entered in an equity case, which is also a command *upon the litigant* (although usually a command to refrain from doing something, whereas the peremptory writ of mandamus commands the affirmative doing of an act).

Consequently, just as the commanding injunctive order to a litigant in an equity case is an order which is reviewable, so is the peremptory writ of mandamus an order which

is reviewable, whether considered alone or as implementing the order of December 28, 1944.

It is said in 38 C. J. 545, section 12 that "... mandamus is a remedy to compel action while injunction is a remedy to prevent action ...".

At 38 C. J. 546, section 15, it is said:

> "In the specific relief which it affords, a mandamus operates much in the nature of a bill in chancery for a specific performance, the principal difference being that the latter remedy is resorted to for the redress of purely private wrongs or the enforcement of contract rights, while the former generally has for its object the performance of obligations arising out of official station or specifically imposed by law upon respondent."

It follows that since the peremptory writ containing the definitive or implementing order was issued January 24th, and the petition for certiorari was filed April 21st of the same year, the petition was filed in time.

Respectfully submitted,

HIRSH W. STALBERG,
Attorney for Petitioner.

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 1187

HARRY E. KALODNER, JUDGE OF THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA, PETITIONER

v.

WEBSTER EISENLOHR, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

INTRODUCTORY STATEMENT

The Securities and Exchange Commission presents this memorandum *amicus curiae*. Its interest in the question presented will appear in the reasons advanced in support of the petition.

OPINION BELOW

The opinion of the Circuit Court of Appeals is reported at 145 F. 2d 316. The District Court wrote no opinion.

JURISDICTION

The writ of mandamus was issued by the Circuit Court of Appeals on January 23, 1945. The petition for a writ of certiorari was filed on April 21, 1945.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1945.

QUESTION PRESENTED

In a pending class suit in a United States District Court, the court was advised that the interests of the plaintiff and of a substantial portion of the members of the class had been purchased by the defendant. There were *prima facie* indications of inadequacy of the disclosures made to the public members of the class and that defendant had given special inducements to counsel for the plaintiff. In these circumstances, did the court have discretion to inquire (through appointment of a special master) whether fraudulent or misleading practices or other misconduct had occurred in contravention of the purposes of the Rule of Procedure relating to dismissal or compromise of class suits?

STATUTE INVOLVED

No statute is involved, but the petition for a writ of certiorari involves the application of Rule 23 (c) of the Rules of Civil Procedure.

STATEMENT

An action was instituted in the District Court of the United States for the Eastern District of Pennsylvania against Webster Eisenlohr, a Pennsylvania corporation, on behalf of all its preferred stockholders, by one Speese, a preferred stockholder. The complaint alleged that control of the corporation had

been usurped through application of an erroneous interpretation of provisions of its by-laws respecting voting rights, and that the corporation was being managed to the injury of the preferred stockholders for the sole benefit of the common stock and a bank which controlled a large block of the common stock. It sought a determination that the exclusive voting power was vested in the preferred stock, and other appropriate relief (R. 15–20).

Issue was joined and an initial hearing was held in the District Court (R. 21–26, 43). Thereafter the corporation circularized its preferred stockholders, offering to purchase their shares, which had a redemption value of $197.25, for $150 (R. 4, 31, 34). At that price it purchased almost all the preferred stock outstanding, including the shares of Speese and other stockholders represented by his counsel (R. 4, 35, 75). Counsel for Speese was apparently instrumental in effecting many of the purchases, for which he was paid commissions of $7.50 per share by the corporation (R. 34, 112). Thereafter counsel for Speese informed the court that he no longer had a client, and no one appeared to continue prosecution (R. 5, 74–75). Upon learning that agreements to pay commissions and other pertinent facts had not been disclosed to the preferred stockholders to whom the offer was made, and that they might otherwise have been misled as to the value of their holdings, the court appointed a special master to make an investigation and report to the court "any facts ascertained by him pertaining to fraud, misconduct,

mismanagement and irregularities in the conduct of the affairs of the Defendant and/or the Offer to the Preferred Stockholders." (Pet. Br. Appendix).[1]

On petition of the corporation, the Circuit Court of Appeals for the Third Circuit issued a writ of mandamus requiring the District Court to vacate its order of reference[2] (R. 141–143). Prior to oral argument thereon, the corporation had redeemed the remaining shares of its outstanding preferred stock (R. 136). Review of the action of the Circuit Court of Appeals in issuing its writ of mandamus is sought in the instant proceeding.

ARGUMENT

It is our position that the action of the District Court in seeking to ascertain all the facts surrounding the purchase by Webster Eisenlohr, Inc., of its outstanding preferred stock was consistent with the court's duties under Rule 23 (c) of the Rules of Civil Procedure.

In a class action the rights of many persons who have not had opportunity to select their representatives are before the court. The situation is parallel

[1] The special master was directed to investigate *inter alia* "The question as to whether or not there was a violation of Rule X–10B–5 'Employment of Manipulative and Deceptive Devices' of the Securities and Exchange Commission." (R. 13.) The order of the Court was amended subsequent to the opinion of the court below to omit the quoted provision (Pet. Br. Appendix) and that portion of the order is not directly involved on this review. (See *infra* p. 13.)

[2] The argument was heard before the court sitting *en banc*. Biggs and McLaughlin, JJ. dissented from the majority view that the order here sought to be reviewed was improper.

to corporate reorganizations where many widely scattered individuals are often represented in court by persons who were either self-appointed or who have broad authority without the customary controls of an intimate lawyer-client relationship. In such cases courts must exercise a more pervasive supervision than would otherwise be required. This Court has emphasized that in corporate reorganizations the court stands "in a position different from that which it occupies in ordinary litigation, where issues are to be determined solely upon such evidence as the contending parties choose to introduce." *First National Bank* v. *Flershem*, 290 U. S. 504, 525. The court may not limit itself to information and issues presented to it by the litigants, since "every important determination by the court calls for an informed, independent judgment; and special reasons exist for requiring adequate, trustworthy information where the jurisdiction rests wholly upon the consent of the defendant who joins in the prayers for relief." *Id.* at 525. We note that in the instant case, the purchase of the plaintiff's shares, while it did not involve dismissal of the suit, left no adversary parties before the court. Nevertheless the mandate of the court below would foreclose in such a suit the searching inquiry which this Court has required in reorganization cases.

The requirement of Rule 23 (c) that no class action may be dismissed or compromised without the approval of the court is recognition of the necessity for

the exercise by the courts of a jurisdiction over class suits comparable to that over reorganizations. Even before the adoption of the federal rules many courts had refused to permit dismissal of class litigation on terms unfair to those on whose behalf the action was brought.[3] The dangers of fraud in the settlement of actions brought on behalf of a class are set forth in McLaughlin, *Capacity of Plaintiff-Stockholder to Terminate a Stockholder's Suit*, (1937) 46 Yale L. J. 421, referred to in the notes of the Advisory Committee on the Rules of Civil Procedure.[4] As is there suggested, the most practical method of settling such litigation is through approval of a proposed settlement by the court, which may, "after examining all the circumstances, reach an independent decision on the fairness of the settlement" *Id.* at 433–34. As was pointed out in *Winkelman* v. *General Motors Corp.* 48 F. Supp. 504, 514 (S. D. N. Y.):

> A question of public policy had developed in actions of this type, due to the private and

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[3] *Whitten* v. *Dabney*, 171 Cal. 621, 154 Pac. 312 (1915); *Naspo* v. *Summit Sweets Shoppe*, 106 N. J. Eq. 49, 150 Atl. 199 (1930); and *Atlas Bank* v. *Nahant Bank*, 23 Pick. 480 (Mass. 1840), and *Honesdale Shoe Co.* v. *Montgomery*, 56 W. Va. 397, 49 S. E. 434 (1904). Cf. *United States Lines, Inc.* v. *United States Lines Co.*, 96 F. 2d 148 (C. C. A. 2, 1938).

[4] See also *Securities and Exchange Commission Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees* (1937), Pt. I, 691–704; Hornstein, *Problems of Procedure in Stockholders' Derivative Suits* (1942) 42 Col. L. Rev. 574, 583–84.

> secret settlement of stockholders suits, made without Court review and without notice to other stockholders. Against that unsavory practice the corrective provisions of Rule 23 (c) were directed.

It is clear that this provision of the Rules was adopted "to secure not routine approval of a consent decree" but to assure supervision of the court for the protection of all persons on whose behalf the action was brought. *Cohen* v. *Young*, 127 F. 2d 721, 725 (C. C. A. 6).

In the instant case the action of the corporation in buying out the preferred stockholders, including the complainant, resulted for all practical purposes in settlement of the litigation. A court of equity, looking to the substance of the transaction, may not draw a distinction between settlements designated as such and settlements effected through the sale of securities. Cf. *Young* v. *Higbee*, No. 342, Oct., 1944, decided February 26, 1945. Indeed, evils of the sort which Rule 23 (c) was designed to cure may be effected as readily through settlements in the guise of sales of securities as through other modes of settlement.[5]

[5] See, e. g., *Manufacturers Mutual Fire Insurance Co.* v. *Hopson*, 176 Misc. 220, 25 N. Y. S. (2d) 502 (N. Y. Sup. Ct. 1940), *aff'd*, 262 App. Div. 731, 29 N. Y. S. (2d) 139 (1941), *aff'd*, 288 N. Y. 668, 43 N. E. (2d) 71 (1942), where the complainant's securities were purchased at a price greatly in excess of the market, the pleadings were withdrawn from the court files, and a stockholder who later discovered the suit and its "settlement" attempted to carry on the litigation but was apparently barred from so doing by the running of the statute of limitations.

Unless the protection to all members of a class whose rights are sought to be enforced purportedly afforded by Rule 23 (c) is to be rendered ineffective, any payments by a defendant to a person who had assumed to litigate on behalf of a class must be subjected to the scrutiny of a court.

The agreement between the litigants which resulted in the sale of the plaintiff's securities was a compromise which, under Rule 23 (c), the parties should have submitted to the court for its approval. Had this been done the court could have prevented the obviously unfair situation in this case where some preferred stockholders fared better than others [6] and where the attorney for the complainant stockholder received his compensation not by allowance of the court but by agreement with the defendant whereby the extent of his compensation depended on the number of preferred shares he could arrange to have sold pursuant to the defendant's offer (R. 112–113). Since the rule provides that the court may require that notice of the proposed compromise "be given to all members of the class in such manner as the court

[6] Since the offer to purchase at $150 was $47.25 less than the redemption value, presumably those preferred stockholders who accepted the offer received that much less per share than those whose shares were ultimately redeemed. (R. 4, 31, 34, 136.)

directs",[7] the court unquestionably could have required disclosure to all the preferred stockholders of all pertinent information relating to the settlement. However, in violation of the rule, the litigants presented the court with a *fait accompli*. The circumstances of the transaction pointed toward fraud practiced by the litigants upon persons whose rights were under the protection of the court. Indeed, there were indications that the complainant, or his counsel, had used the process of the court to further his own ends in violation of obligations owing to the other members of the class. Cf. *Young* v. *Higbee, supra.* It was within the power and indeed the duty of the court to prevent circumvention of the rule designed for the protection of the non-litigating members of the class and to investigate possible abuse of the court's process.

The Commission takes no position as to whether there was in fact any fraud or misconduct or whether, if inquiry were made, the circumstances revealed would warrant the court in acting for the protection of the members of the class affected. It is our position, however, that the court had the power to determine the facts and that if fraud or misconduct were

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[7] The requirement of notice may well have been mandatory here. Although the petitioner treats the action as a spurious class suit under Rule 23 (a) (3), it is by no means clear that it was not a true class action seeking to enforce common rights under Rule 23 (a) (1). *Cf. Supreme Tribe of Ben-Hur* v. *Cauble*, 255 U. S. 356, cited as an illustration of a class action under subdivision (1) by the Advisory Committee on the Rules for Civil Procedure.

found the court would not be powerless to give redress. Equity provides numerous remedies by which the court might frustrate misconduct by the defendant or breach of fiduciary duty by the plaintiff. Rescission, additional payments by the defendant to defrauded stockholders, payment by the complainant or its counsel to other members of the class of sums received in violation of fiduciary duties, or contempt proceedings might be applicable here.[8] This Court, in a case dealing with fraud perpetrated on a court, recently had occasion to discuss the flexibility of equitable procedure "to meet new situations which demand equitable intervention, and to accord all the relief necessary to correct the particular injustices involved." *Hazel-Atlas Co.* v. *Hartford-Empire Co.*, 322 U. S. 238, 248.

Determination of the appropriate relief is peculiarly within the area which should be policed by the district court before which the improper practices were committed. This requires a wide range of inquiry by that court, and where, as in this case, the interests of the litigants are not such as to provide a basis for an independent judgment, the court should be free to appoint its own agent to make a thorough examination of the situation. Certainly, if inquiry

[8] The petitioner urges that the prayer for receivership in the original complaint in the class suit affords a basis for possible relief. (Pet. Br. pp. 9–10; Cf. footnote 5 to dissenting opinion, R. 132–133.) In our view the court's power and duty to take appropriate action for the protection of members of the class should not be affected by the absence or presence of such prayer in the complaint.

into all the facts surrounding the settlement is within the power of the court, as we contend it must be, the circumstances of this case are "exceptional" within the meaning of the requirement of Rule 53 (b), relating to a reference to a special master. Cf. *Ex parte Peterson*, 253 U. S. 300, 312–314.

By issuing its writ of mandamus the Circuit Court of Appeals thwarted the District Court in its attempt to determine what action, if any, it should take. Petitioner urges that "interlocutory, discretionary orders of the district court are not subject to control or review by mandamus in an appellate court." If the majority of the court below were clearly correct in their conception of the duties of a district court with reference to disposition of a class suit by consent, our interest would not lead us as *amicus curiae* to question the availability of the extraordinary remedy of mandamus. Once it is recognized, however, that the district court has a duty to exercise an informed independent judgment and to insist upon appropriate action for the protection of members of the class affected, then we submit that such inquiry should not be impeded through interlocutory review. Mandamus or prohibition would be warranted only upon a clear showing of action in excess of jurisdiction. Even where action in excess of prescribed jurisdiction is alleged, "appellate courts are reluctant to interfere with the decision of a lower court on jurisdictional questions which it was competent to decide and which are reviewable in the regular course of appeal." *Roche* v. *Evaporated*

Milk Association, 319 U. S. 21, 26. Mere inconvenience of the litigants is not such a special circumstance as to justify issuance of the writ of mandamus. *Id.* at 31.

The question presented is of importance in connection with the protection of members of the investing public. It also involves the problem of the relative functions of courts and administrative agencies in the protection of the public interest. The statutes administered by the Commission do not vest it with exclusive standing to protect the interests of security holders. In many respects the purpose of the disclosure requirements in these statutes is merely to afford interested security holders a chance to protect their own rights.[9] Since in many instances security holders affected are scattered and the individual stake of any one of them is relatively small, the class suit is an important instrument for their protection. Congress has found that individual action by investors "for the purpose of protecting and enforcing their rights is rendered impracticable by reason of the disproportionate expense of taking such action."[10] To the extent that any decision

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[9] See Securities Act of 1933, Sections 11 and 12; Securities Exchange Act of 1934, Sections 9 (e), 18 (a), and 29 (b). Cf. *Baird* v. *Franklin*, 141 F. 2d 238 (C. C. A. 2, 1944), holding that the Securities Exchange Act of 1934 grants a right of action to persons injured by its violation even apart from any specific provision for civil liability. Provisions for civil liability are also contained in other statutes administered by the Commission.

[10] Trust Indenture Act of 1939, Section 302 (a) (1).

forecloses inquiry into the fairness of settlements of class suits, causes of action provided for injured investors in the statutes administered by the Commission are made less effective.

Both the majority and the minority opinions of the court below agreed that the District Court erred in undertaking to inquire into a possible violation of the Commission's Rule X–10B–5 pursuant to the Securities Exchange Act of 1934, applicable to fraud in the purchase of securities (R. 125–126, 136). This issue has been eliminated from the petition by reason of modification of the original order of the District Court. Nevertheless, it remains pertinent to suggest that the court below showed an unnecessary concern to protect the Commission from possible invasion of its administrative functions. Of course, we should not regard investigation of a violation of that rule as *per se* an appropriate function of the District Court; but since the same facts which might constitute a violation of the Commission's rule might also prove relevant to the court's duties under Rule 23 (c) of the Rules of Civil Procedure, we believe that there was no necessity for curbing the scope of the investigation as originally ordered. The subsequent modification of the District Court's decision does not completely eliminate this issue, since we believe that the overlapping character of the two issues may have been responsible in part for what appears to us an unduly restrictive conception by the court below of the duties of a court in which a class action is pending.

CONCLUSION

For the reasons stated it is respectfully submitted that the petition for a writ of certiorari should be granted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 1187.

HARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,
Petitioner,

vs.

WEBSTER EISENLOHR, INC.,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF OF RESPONDENT IN REPLY TO MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION.

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As pointed out in our brief in opposition to the petition for certiorari, this Court is without jurisdiction to entertain the petition because it was filed more than three months after the entry of the final decree whose review is sought.

The memorandum submitted on behalf of the Securities and Exchange Commission (hereinafter called the "Commission"), as *amicus curiae*, completely ignores the jurisdictional point. No reference is made, under the heading "jurisdiction" or elsewhere, to the date of entry of the final decree, namely, December 28, 1944. The only refer-

ence is to January 23, 1945, the date of the writ of mandamus, which was the *process* issued in *execution* of the final decree.[1]

The Commission was advised of the *Speese* suit and of the remarks of Judge Kalodner criticizing respondent's offer to its stockholders more than two years ago (R. 62a). Its legal representative, who was in court when the matter came before Judge Kalodner on May 24, 1943, was requested, by Judge Kalodner, to stay and report to the Commission. He agreed to do so (R. 72a). As a matter of fact, respondent's counsel furnished the Commission, about that time, with copies of all the documents relating to the offer and explained the entire matter to several representatives of the Commission at Philadelphia. Despite all this, the Commission has sought to take no part either in the *Speese* suit before Judge Kalodner or in the proceedings before the Court below, nor does it cite any statutory or other authority which gives it the right to be heard here. Even now, despite its full information, the Commission does not contend that there was any fraud or misconduct, or that an inquiry would reveal any circumstances which would warrant court action (see its brief, p. 9).

Nevertheless, since the Commission is an agency of the Government, we deem it appropriate to point out that its memorandum lends no support to the petition for certiorari.

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[1] It is clear, beyond dispute, that the petition was filed too late. In addition to the cases cited in respondent's brief in opposition (p. 8), see *Radford* v. *Folsom*, 131 U. S. 392 (1888).

Petitions tardily filed have been consistently denied. *Salmon* v. *U. S.*, 289 U. S. 732; *Rust Land Co.* v. *Jackson*, 250 U. S. 71, 76; *Dept. of Banking* v. *Pink*, 317 U. S. 264.

It is, of course, too late now for petitioner to obtain an extension of time in which to file his petition. *Cresswell ex rel. Di Pierro* v. *Tillinghast*, 286 U. S. 560 (1931).

The Commission first seeks to transform an ordinary stockholder's suit to procure the construction of a single provision of the charter and by-laws of a corporation into a proceeding akin to a corporate reorganization in which the Court exercises general supervision over the properties of the insolvent or bankrupt corporation. As the Commission's memorandum itself points out (p. 5), a corporate reorganization is an entirely different type of proceeding from ordinary litigation "where issues are to be determined solely upon such evidence as the contending parties choose to introduce." Since the Commission's premise is unjustified and unsound, its arguments based thereon are inapplicable.

The Commission further contends that "the agreement between the litigants which resulted in the sale of the plaintiff's securities [in the *Speese* action] was a compromise which, under Rule 23(c), the parties should have submitted to the Court for its approval".

There was no agreement between litigants in the *Speese* suit. There was merely a general offer by the defendant (respondent in this Court) to *all* its preferred stockholders to purchase their stock—an offer which was accepted by holders of 4,047 out of 5,037 shares of respondent's preferred stock.[2]

There was no settlement or compromise of the *Speese* suit. That suit was not dismissed—in fact it is still pending.[3]

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[2] It sould be noted that this offer did not result from the institution of the *Speese* suit but was the culmination of discussions initiated almost a year earlier when respondent's directors appointed a committee to consider the matter (R. 69a, 113a).

[3] Although the only issue in the case was squarely presented by the pleadings which thus permitted a prompt determination thereof, the case has not been tried or determined by the District Court in spite of the fact that it has been pending for more than two years (R. ii), and that respondent was ready to proceed with the trial a few months after issue was joined (R. 74a).

The holders of the 990 shares of preferred stock who did not accept respondent's offer were free to intervene in and to prosecute the *Speese* suit. They were formally advised of their rights in this connection (R. 5a, 35a). Two years have elapsed, but none has attempted to intervene.

Furthermore, if any stockholder who accepted the offer felt that he had been defrauded, he was free to assert his claim in a proper proceeding before a court of competent jurisdiction. No such proceeding has been commenced nor has any claim of fraud been made, even to respondent, by anyone who accepted the offer.

Rule 23(c) has never been construed to cover a situation like that presented here (see our main brief, pp. 13-14). The order of reference (R. 13a-15a) made by the District Court did not purport to be made pursuant to Rule 23(c) and did not refer to the Special Master any question as to whether the action should be compromised or dismissed.

The avowed and patent purpose of the order of reference was to initiate an investigation by the District Court, through a Special Master, to determine if persons, who were fully capable of acting for themselves, had any rights which could be asserted by litigation or otherwise. This is a far cry from the judicial functions, which, alone, under the Constitution, District Courts may exercise.

In addition to asserting that respondent's purchase of the plaintiff's stock resulted in a settlement of the *Speese* action which required court approval under Rule 23(c), the Securities and Exchange Commission asserts that "there were indications that the complainant, or his counsel [in the *Speese* action] had used the process of the court to further his own ends in violation of obligations owing to the other members of the class" and that "It was within the power * * * of the court * * * to investigate possible abuse of the court's process." In this connection the Com-

mission cites *Hazel-Atlas Co.* v. *Hartford-Empire Co.*, 322 U. S. 238, 248, as illustrative of a court's power to deal "with fraud perpetrated on a court". But there has been no claim either by the District Judge in the *Speese* action or by any judge of the Circuit Court of Appeals in the present proceeding that any fraud upon the District Court has been committed or attempted. Judge Kalodner's extraordinary, self-prepared order of reference (R. 13a-15a) shows that it was not designed to determine whether there had been a fraud upon the District Court. On the contrary, its entire object was to determine whether or not there had been a fraud upon third parties (in connection with matters not involved in the *Speese* suit). If a fraud has been committed upon third parties, they, not the District Judge, are the ones to assert it.

Although the Commission purports to take "no position as to whether there was in fact any fraud or misconduct", it asserts that "There were *prima facie* indications of inadequacy of the disclosures made to the public members of the class", and that "The circumstances of the transaction pointed toward fraud * * *." The lack of any foundation for such statements is sufficiently demonstrated in the appendix to respondent's main brief (pp. 15-20). Here we desire only to point out that at no time has any claim of fraud or unfairness been made by anyone but Judge Kalodner. His remarks during the proceedings before him and the order of reference received considerable publicity. His words and acts and the publicity which attended them were of the kind which would be inclined to foment litigation. Notwithstanding these provocatory circumstances *not a single one of respondent's preferred stockholders has shown any interest whatever in the District Judge's inexplicable crusade against respondent.* On the

contrary, the District Judge has attempted to be a champion where he has no cause and to be a leader where he has no following.

Conclusion.

The Petition should be denied.

Dated, May 24, 1945.

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